IN THE UNITED STATES BANKRUPTCY COURT FOR THE EASTERN DISTRICT OF TENNESSEE

In re

Case No. 99-31499

RACHEL Y. FRANKLIN WEST
a/k/a RACHEL Y. WEST
a/k/a RACHEL Y. FRANKLIN

Debtor

RACHEL Y. WEST
a/k/a RACHEL Y. FRANKLIN

Plaintiff

v. Adversary No. 99-3100

EDUCATIONAL CREDIT
MANAGEMENT CORP.

Defendant

MEMORANDUM ON COMPLAINT
TO DETERMINE DISCHARGEABILITY

APPEARANCES: MOSTOLLER, STULBERG & WHITFIELD
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RICHARD STAIR, JR.
UNITED STATES BANKRUPTCY JUDGE

On June 22, 1999, the Debtor filed a Complaint to Determine Dischargeability against Educational Credit Management Corporation (ECMC).[1] ECMC filed an Answer to Complaint to Determine Dischargeability on July 22, 1999. The issue before the court is whether the Debtor's student loans should be discharged. In addition to the evidence introduced at the trial of this matter on April 18, 2000, the parties stipulated certain undisputed facts through a Stipulation of Debtor and Educational Credit Management Corporation filed on April 14, 2000.

This is a core proceeding. 28 U.S.C.A. § 157(b)(2)(I) (West 1993).

I

In 1989, the Debtor began her college education at Cumberland College in Williamsburg, Kentucky, where she majored in education. Her parents were able to pay for her first semester of college. She obtained student loans in order to attend college for approximately three and a half more years, earning a bachelor of science degree in education with an emphasis in special education in May 1995. The Debtor is licensed to teach special education to children in kindergarten through twelfth grade and will be licensed in pre-kindergarten education if she completes a few remaining requirements.

The Debtor obtained four loans from ECMC for which she owed the total amount of $26,447.52 on April 12, 1999, the date she filed her Chapter 7 petition. This amount includes $18,316.31 in principal, $3,606.11 in interest, and $4,525.10 in fees and costs of collection.

[1] The original named defendant was USA Group Guarantee Service, Inc. The error was corrected by an amendment to the Complaint pursuant to the Pre-Trial Order entered on October 29, 1999.

Interest on her loans accrues at $3.93 per day. The Debtor made payments of $135.00 on December 30, 1998, January 30, 1999, and February 2, 1999, and she obtained a forbearance of payment in October 1995 and again in July 1996 for a total of twelve months. The Debtor testified that she used the loans to pay for her tuition, books and other educational expenses, and that she worked in a movie rental store and fast food restaurant to earn additional money while attending school. Although she would like to earn a master's degree which would enable her to earn more money, she testified that she cannot afford to do so.

In 1991 while attending college, the Debtor married. On September 16, 1995, six months after her college graduation, her son, Aaron West, was born. She separated from her husband on February 17, 1996, and on June 23, 1997, the Chancery Court for Anderson County, Tennessee, entered its Final Decree of Divorce. Pursuant to that decree, the Debtor has sole custody of her son and does not receive child support. She remains a single parent.

The Debtor testified that she began working as a teacher in January 1997 as a substitute for an elementary school teacher who was taking three months of medical leave. After that assignment, she worked for two weeks in another substitute position. She obtained full-time employment in September 1997 at an alternative school in Scott County, Tennessee. In that position she taught GED students, troubled teenagers, and special education students. For the following year, she obtained a teaching position at Scott County High School, where she worked during the 1998 to 1999 and 1999 to 2000 school years. At this time, she has earned three full years toward a tenured position. The Debtor testified that as soon as she signs a contract of employment at Scott County High School for the 2000 to 2001 school year and works the first

day of that contract she will have a tenured position. Although she will not know officially whether she will be rehired until July 2000, the Debtor testified that she has no reason to believe that she will not be rehired.

The Debtor testified that she is not qualified for work in fields other than education. In 1997 and in previous years, the Debtor worked during the summer months in jobs earning at or near minimum wage. She testified that she does not plan to work in the summers because she feels that it is important to be home with her son during those eight weeks and because much of her earnings in those jobs would be absorbed by child care expenses.

The Debtor filed a Chapter 7 petition on April 12, 1999, accompanied by schedules and statements. She scheduled liabilities totaling $55,244.00. Of that amount, $25,068.00 represents the debt to ECMC and $29,419.00 represents student loan debt owing to Kentucky Higher Education. The dischargeability of the debt owing to Kentucky Higher Education was the subject of another adversary proceeding before this court, Adv. Proc. No. 99-3101, which had been consolidated for trial with this adversary proceeding. That matter was settled prior to trial.

The Debtor scheduled her estimated average monthly gross income as $2,154.00 and her average monthly net income as $1,439.00. She testified that in the fall of 1999 she received a raise of approximately $50.00 per month and that she expects to continue receiving annual raises in the same approximate amount. The Debtor explained that she could earn more at a school in a different geographical area, but does not wish to leave Campbell County, where she has lived for

most of her life and where her siblings and father still reside. Her father, a truck driver, occasionally assists the Debtor financially, but she testified that his ability to do so is limited.

The Debtor scheduled monthly total expenses of $1,685.00. Included in that figure is a $200.00 expense that she anticipates for payments on a car which she expects to need. It is not clear whether she will actually purchase another car in the near future. She lists a monthly expense of $40.00 in repairs for the car that she currently drives. She testified that the car is her father's 1987 Nissan; that it has been driven 174,000 miles; that it cannot hold a full tank of gas and uses over a quart of oil each week; that it is in bad condition; and that it is often repaired with no charge for labor by students at her school through an educational program. The Debtor relies heavily on the car for her commute to work and has put almost 10,000 miles on the car since November 1999.

The Debtor's remaining monthly expenses were $300.00 for rent, $95.00 for electricity, $15.00 for water and sewer, $100.00 for telephone, $400.00 for food, $100.00 for clothing, $50.00 for medical and dental, $80.00 for transportation, $30.00 for recreation and related expenses, $50.00 for automobile insurance, $200.00 for child care, and $25.00 for haircuts. The Debtor's testimony did not include an explanation of the relatively large telephone expense. The Debtor's child care expense will decrease dramatically in the fall of 2000 when her son begins kindergarten. Further, based on the Debtor's testimony that she stays at home with her son during the summers, she should not incur substantial child care expenses over those months either.

After the filing of the Debtor's schedules, she incurred an unexpected additional medical expense of $700.00 when her son became ill for several months in 1999. While the Debtor testified that she is still paying that debt, she did not testify as to how much of the debt remains or how long she may need to repay it. Because the court does not know whether and in what amount that debt may be a part of her budget, it will not consider it as part of her budget. Neither she nor her son has an ongoing health problem that would require similar expenses on a more routine basis.

Finally, the Debtor testified at trial about the status of her student loan debt owing to Kentucky Higher Education, which will be an additional expense in her budget. She explained that she and Kentucky Higher Education reached a settlement of the adversary proceeding concerning the dischargeability of her student loan debt owing to it. The amount of the monthly payment that she must make under that settlement is a function of the outcome of this dischargeability proceeding between the Debtor and ECMC. Specifically, the Debtor has agreed to pay $100.00 per month for fifteen years to Kentucky Higher Education if the debt owing to ECMC is not discharged, but she will pay $200.00 per month for fifteen years to Kentucky Higher Education if the debt to ECMC is discharged.

II

The dischargeability of student loans is governed by 11 U.S.C.A. § 523(a) (West Supp. 2000) which provides:

> A discharge under section 727 . . . of this title does not discharge an individual debtor from any debt—

. . . .

> (8) for an educational benefit overpayment or loan made, insured or guaranteed by a governmental unit, or made under any program funded in whole or in part by a governmental unit or nonprofit institution, or for an obligation to repay funds received as an educational benefit, scholarship or stipend, unless excepting such debt from discharge under this paragraph will impose an undue hardship on the debtor and the debtor's dependents[.]

In the absence of a definition of "undue hardship" in the Bankruptcy Code, the Sixth Circuit has used the following factors for analysis under § 523(a)(8):

> "One test requires the debtor to demonstrate '(1) that the debtor cannot maintain, based on current income and expenses, a "minimal" standard of living for herself and her dependents if forced to repay the loans; (2) that additional circumstances exist indicating that this state of affairs is likely to persist for a significant portion of the repayment period . . . ; and (3) that the debtor has made good faith efforts to repay the loans.'"

Tennessee Student Assistance Corp. v. Hornsby (In re Hornsby), 144 F.3d 433, 437 (6th Cir. 1998) (quoting *Cheesman v. Tennessee Student Assistance Corp. (In re Cheesman)*, 25 F.3d 356, 359 (6th Cir. 1994)). In addition, the Sixth Circuit has explained that,

> A bankruptcy court might also consider, among other things, "the amount of the debt . . . as well as the rate at which interest is accruing" and "the debtor's claimed expenses and current standard of living, with a view toward ascertaining whether the debtor has attempted to minimize the expenses of himself and his dependents."

Id. (quoting *Rice v. United States (In re Rice)*, 78 F.3d 1144, 1149 (6th Cir. 1996)).

In *Hornsby*, the Sixth Circuit clarified that not all debtors who must repay student loans on a modest budget experience undue hardship as required under § 523(a)(8). *See id.* at 438. Although student loan repayment may be financially burdensome on all debtors with modest budgets, only those debtors with a modest *and* unbalanced budget may receive a discharge. *See*

id. Thus, if a debtor minimizes her expenses as much as possible, eliminating frivolous or unnecessary expenditures, but still has a budget deficit, that debtor satisfies the undue hardship factors regarding ability to pay. *See id*.

In *Hornsby*, the bankruptcy court had discharged the debtors' student loans. *See id*. Upon review, the Sixth Circuit reversed and remanded the decision concluding that the record did not show that the debtors' circumstances rose to the level of undue hardship. *See id*. It cited the debtors' monthly budget surplus of $200.00 as evidence of their ability to repay the loans and criticized the bankruptcy court for failing to question their expenses and, in particular, their $100.00 monthly expense for cigarettes and a large long distance telephone expense. *See id*. It also criticized the bankruptcy court's failure to make a more detailed finding with regard to the debtors' good faith, noting that the debtors had made no payments on the loans, or to analyze the possibility that their circumstances would improve over the loan repayment term. *See id*.

The Sixth Circuit also concluded that the bankruptcy court "had the power to take action short of total discharge." *Id*. It found that the equitable power granted to bankruptcy courts under 11 U.S.C.A. § 105(a) (West 1993)[2] enables bankruptcy courts to fashion a remedy other than complete discharge of student loans. *See id*. at 439; *see also Cheesman*, 25 F.3d at 360 (approving under § 105(a) the bankruptcy court's authority to stay its order discharging student loans and reconsider it after eighteen months). *But cf. Andresen v. Nebraska Student Loan Program, Inc. (In re Andresen)*, 232 B.R. 127, 129-137 (B.A.P. 8th Cir. 1999) (recognizing a

[2] Bankruptcy Code § 105(a) provides that "[t]he court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title."

disagreement among the courts as to whether § 105(a) authorizes the use of equitable remedies under § 523(a)(8) but finding that the issue was not before it); *United Student Aid Funds, Inc. v. Taylor (In re Taylor)*, 223 B.R. 747, 754 (B.A.P. 9th Cir. 1998) (disagreeing with the Sixth Circuit's use of § 105(a) "to trump the statutory limitations of § 523(a)(8)"). The court explained that "where undue hardship does not exist, but where facts and circumstances require intervention in the financial burden on the debtor, an all-or-nothing treatment thwarts the purpose of the Bankruptcy Act." *Hornsby*, 144 F.3d at 439. While clarifying that the scope of such equitable power remains undefined in the Sixth Circuit, it recognized various equitable remedies fashioned by bankruptcy courts:

> Where a debtor's circumstances do not constitute undue hardship, some bankruptcy courts have thus given a debtor the benefit of a "fresh start" by partially discharging loans, whether by discharging an arbitrary amount of the principal, interest accrued, or attorney's fees; by instituting a repayment schedule; by deferring the debtor's repayment of the student loans; or by simply acknowledging that a debtor may reopen bankruptcy proceedings to revisit the question of undue hardship. We conclude that, pursuant to its powers codified in § 105(a), the bankruptcy court here may fashion a remedy allowing the [debtors] ultimately to satisfy their obligations to [the lender] while at the same time providing them some of the benefits that bankruptcy brings in the form of relief from oppressive financial circumstances.

Id. at 440.

Upon remand, the bankruptcy court determined that the debtors were not entitled to a discharge for any of their student loans. *See Hornsby v. Tennessee Student Assistance Corp. (In re Hornsby)*, 242 B.R. 647, 653 (Bankr. W.D. Tenn. 1999). Noting its option to partially discharge the debt upon some finding of financial hardship under the Sixth Circuit's opinion, the court chose instead to permit the debtors to repay their student loans on a graduated repayment

schedule. *See id*. In reaching its decision, the court considered that the debtors had purchased a computer, that they pay for internet service, that they pay $65.00 monthly for cable service which includes access to several movie channels, that they took a vacation during the past summer, that after the bankruptcy court's original decision they had purchased two new automobiles with monthly payments exceeding $400.00 each, and that the debtors' monthly income of $3,500.00 was nearly twice the income set in the national poverty guidelines for a family their size.[3] *See id*.

Prior to *Hornsby*, the Sixth Circuit decided *Cheesman*. There, the court approved of the bankruptcy court's discharge of the student loans of two debtors who were married and had two children. *See Cheesman*, 25 F.3d at 358. The court found that a discharge for undue hardship was appropriate where the debtors had a frugal lifestyle, their daughter attended private school with tuition paid mostly by relatives, they had continuing medical expenses related to the treatment of their daughter's asthma, they showed good faith by making some partial payments, their gross income was slightly above the poverty level for a family of their size, the husband worked as an "early intervention specialist" at a mental health center, and the wife hoped to find employment perhaps as a teacher's aide. *See id*. at 359-60. The court also highlighted that the debtors "chose to work in worthwhile, albeit low-paying professions" and that it found "no indication that they were attempting to abuse the student loan system by having their loans forgiven before embarking on lucrative careers in the private sector." *Id*. at 360.

[3] One of the debtors worked outside the home and the other stayed home with their three children.

III

At the outset of its analysis, the court must consider the fact that the Debtor, by testifying about the terms of her settlement with Kentucky Higher Education, inescapably admitted her belief that she can afford a student loan repayment of $200.00 each month for fifteen years. The sum of that repayment would amount to $36,000.00. If ECMC prevails here by having its claim declared nondischargeable, then the Debtor's monthly obligation to Kentucky Higher Education under the settlement drops to $100.00, leaving the remaining $100.00 available to pay ECMC. Thus, by testifying that she entered into that adjustable settlement, the Debtor tacitly acknowledges that she is prepared to pay at least $100.00 each month for fifteen years to ECMC, which would amount to $18,000.00. Accordingly, the court's point of departure in the dischargeability issue before it is not whether the Debtor can afford to make any student loan repayments, but rather, how much can she afford to pay over and above the $100.00 that she has already budgeted for it.

The Sixth Circuit's decision in *Hornsby* directs the court to consider whether a debtor has a modest but unbalanced budget, whether the debtor's circumstances are likely to persist over time, and whether the debtor has made a good faith effort to repay the loans. *See Hornsby*, 144 F.3d at 437. The good faith factor can be characterized as neutral at best for this Debtor. Although she made three payments of $135.00 just prior to filing her petition in early 1999, she did not make a single payment in any amount from 1995 through November 1998. Her loans were in a forbearance status for only twelve months of that time.

The Debtor's budget is summarized in her schedules of income and expenses, as supplemented by her testimony. In April 1999, the Debtor scheduled an average monthly income of $1,439.00 and average monthly expenses of $1,685.00. The Debtor received a $50.00 annual raise in the fall of 1999. Her scheduled expenses included an expected monthly car payment of $200.00 and a monthly car repair expense of $40.00 for the car she currently drives. At trial, the Debtor testified that she has not purchased a car and does not know whether she will. Therefore, the Debtor's monthly expenses have actually been, and currently are, $1,485.00 monthly. In addition, the Debtor scheduled a monthly telephone bill of $100.00. The Sixth Circuit has explained that courts should consider whether expenses are unnecessarily large or unjustified when making an undue hardship determination. *See id.* at 438. The Debtor has not explained the necessity for such a substantial monthly telephone bill and the court will consider that her telephone expense should be somewhat less than $100.00. Thus, although the Debtor's budget seems unbalanced as it appears in her schedules, it was not unbalanced at the time of the trial.

In addition, the Debtor testified that her $200.00 monthly expense for child care will significantly decrease, if not disappear, when her son begins school in the fall. That expense will actually decrease or disappear beginning in June when the Debtor's summer break begins. She testified that she anticipates that there will be some expenses related to her son's schooling which will offset the child care expenses to some extent. While the Debtor's child care expense decreases in the upcoming months, the Debtor expects to receive another annual raise of $50.00 each month. The Debtor expects to continue receiving annual raises in that amount.

Finally, the court sees no indication that the Debtor's finances are likely to change considerably in the future. She has no plans to leave her profession or her home, she is working at the maximum level of her training, and there is no evidence to indicate that any other significant financial change is on the horizon. It is likely, however, that the Debtor will need another vehicle in the near future in order to commute to work.

Keeping in mind the foregoing analysis of the Debtor's good faith and budget and her tacit admission that she can pay ECMC at least $100.00 monthly for fifteen years in repayment of her loan, the court must now decide whether the Debtor should repay the entire debt to ECMC or whether it may partially discharge the debt. Under *Hornsby*, the court is permitted to fashion an equitable remedy, such as partial discharge, under § 523(a)(8). *See id*. at 439.

The Debtor did not testify as to how she would be able to pay $200.00 monthly under her settlement with Kentucky Higher Education. The court will presume that the source of that payment will be the $200.00 monthly savings that the Debtor will enjoy beginning in June when her regular child care expense decreases or disappears. That presumption is supported by the identity between the savings amount and the settlement amount and the coincidence in the timing between the inception of the savings and the resolution of this matter, upon which the payment of the settlement is contingent.

Because the Debtor will probably need another vehicle soon, the court will keep the car payment expense in the budget and will extract the monthly car repair expense. In addition, the court will apply a minor reduction to the unexplainedly large telephone expense. Although the

court cannot place a dollar figure on it, the Debtor is entitled to some monthly allowance for unanticipated expenses. Finally, the Debtor will receive annual raises over the repayment period, which, although modest, will increase her earnings in the years to come. The court finds that the Debtor is able to pay an additional $25.00 to ECMC each month. Thus, the Debtor will pay $125.00 to ECMC each month for fifteen years for a total repayment of $22,500.00. Payments will be due by the fifth day of each month commencing in June 2000. In the event of a default, the Defendant may declare the entire nondischargeable balance due. The remainder of the Plaintiff's obligations will be discharged.

An appropriate judgment will be entered.

FILED: May 10, 2000

BY THE COURT

/s/ Richard Stair, Jr.

RICHARD STAIR, JR.
UNITED STATES BANKRUPTCY JUDGE

IN THE UNITED STATES BANKRUPTCY COURT FOR THE EASTERN DISTRICT OF TENNESSEE

In re

Case No. 99-31499

RACHEL Y. FRANKLIN WEST
a/k/a RACHEL Y. WEST
a/k/a RACHEL Y. FRANKLIN

Debtor

RACHEL Y. WEST
a/k/a RACHEL Y. FRANKLIN

Plaintiff

v. Adversary No. 99-3100

EDUCATIONAL CREDIT
MANAGEMENT CORP.

Defendant

J U D G M E N T

For the reasons stated in the Memorandum filed this date containing findings of fact and conclusions of law as required by FED. R. BANKR. P. 52(a), it is ORDERED, ADJUDGED, and DECREED as follows:

1. The student loan obligations of the Plaintiff, Rachel Y. West, to the Defendant, Educational Credit Management Corp., are nondischargeable under 11 U.S.C.A. § 523(a)(8) (West Supp. 2000) to the extent of $22,500.00. The balance of the Plaintiff's obligations are discharged.

2. The Plaintiff shall satisfy her nondischargeable obligations to the Defendant by making payments of $125.00 each month for 180 months with each payment to be made on or before the fifth day of the month commencing in June 2000.

3. If the Plaintiff fails to make timely payments, the entire nondischargeable balance may be declared due by the Defendant.

ENTER: May 10, 2000

BY THE COURT

/s/ Richard Stair, Jr.

RICHARD STAIR, JR.
UNITED STATES BANKRUPTCY JUDGE